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No. 642

In the Supreme Court of the United States

OCTOBER TERM, 1958

THE CHASE MANHATTAN BANK, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The prevailing and dissenting opinions in the Tax Court (Pet. 29–42) are reported at 25 T.C. 617. The opinion of the Court of Appeals (Pet. 45–101) is reported at 259 F. 2d 231.

JURISDICTION

The judgment of the Court of Appeals was entered on August 19, 1958. (Pet. 103.) A petition for rehearing was denied on October 23, 1958. (Pet. 105.) The petition for a writ of certiorari was filed on January 12, 1959. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. The husband in a community property state (Texas) created an insurance trust the principal of which consisted of insurance policies on his life. All premiums were paid out of community property. Upon his death the income was to go to his wife for life, and when she died, the principal was to go to the settlor's descendants. The husband reserved the right to revoke the trust and change the beneficiaries of the insurance. When he died, the trust became irrevocable and the rights of the beneficiaries vested. In the circumstances, did the Court of Appeals correctly hold that on the husband's death the wife made a taxable gift of half the proceeds of the insurance less only the value of her retained life estate in that half?

2. The husband also created an *inter vivos* trust out of community property the principal of which consisted of various securities. Income was payable first to him for life, then to his wife for life, with remainder to the settlor's descendants. The husband reserved the right to revoke, and the trust became irrevocable when he died. In the circumstances, did the Court of Appeals correctly hold that on the husband's death there was a completed gift by the wife of half the value of the corpus less only her retained life estate in such half?

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the Internal Revenue Code of 1939 (Sections 1000, 1002, 1005 and 1025) and Treasury Regulations 108 (Sections 86.1, 86.2, 86.3, 86.8, 86.17 and 86.58) are set forth in the Appendix, *infra*, pp. 12–17.

STATEMENT

The facts, as found by the Tax Court (Pet. 26–29) and the Court of Appeals (Pet. 47–48), may be summarized as follows:

Daniel James Moran (hereinafter called Daniel) and Marie Elizabeth Moran (hereinafter called Marie) were married prior to 1922 and remained husband and wife until Daniel's death on April 3, 1948. They resided at all material times in Houston, Texas. At no time from 1922 to the date of his death did Daniel have any separate property. (Pet. 26, 47.)

On November 2, 1928, Daniel created an *inter vivos* trust naming as trustee a predecessor to the taxpayer bank.[1] The trust estate consisted of securities which had belonged to the community. The income was payable to Daniel for life, then to Marie for life, with remainder to the settlor's descendants. Daniel reserved the right to alter, amend or revoke the trust. (Pet. 26, 47.)

On the same day (Nov. 2, 1928) Daniel created an insurance trust with the same trustee. The principal consisted of various insurance policies on the life of Daniel. He reserved the power to alter, amend or revoke the trust and to change the beneficiaries of the insurance. Premiums were paid out of community property. Upon Daniel's death the income was to go to Marie for life. When she died the principal was

[1] The term "taxpayer" is used herein for convenience in referring to the transferee-bank, although the transferor, Marie, is the original taxpayer whose taxes are involved.

to go to the settlor's descendants. (Pet. 26–27, 47–48.)[2]

On April 3, 1948, the corpus of the *inter vivos* trust amounted to $640,480.49. The value of Marie's life interest in one-half of the principal on that date was $128,689.18, and the value of her life interest in the entire corpus was $257,378.37. (Pet. 27.)

Following Daniel's death on April 3, 1948, the proceeds of the insurance policies in the insurance trust were paid to the trustee. The total proceeds were $239,014.04. The value of Marie's life interest in one-half of the insurance trust was $48,024.13; and the value of her life interest in the entire trust was $96,048.25. (Pet. 27.)

The Commissioner determined that on April 3, 1958, the date of Daniel's death, the insurance trust and the *inter vivos* trust became irrevocable; and as of that date Marie made gifts of her community one-half interest in the corpus of each trust less only her life estate in such one-half. (R. 21–24.) The resulting deficiency in gift tax was asserted against the taxpayer as trustee and transferee. No attempt has ever been made to collect from Marie. (Pet 29, 47.)

The Tax Court held (Pet. 37–39) that there was no gift at all by the surviving spouse as to the insurance trust; and that as to the *inter vivos* trust there was a gift measured by the difference between the value of Marie's one-half interest in the corpus less the value

[2] The opinions below deal also with a testamentary trust comparable in its terms to the insurance and *inter vivos* trusts (Pet. 39–40, 57–66). The decision on that portion of the case was adverse to the respondent. Since he has not petitioned for certiorari the liability of the taxpayer on that trust is not before the Court.

of her life estate in the entire corpus (Pet. 36–37).

The Court of Appeals decided (Pet. 89–90) that when Daniel died there was a completed gift of the insurance proceeds; one-half of which fell into the taxable estate of the deceased husband and the other half was a taxable gift from the surviving spouse, less, however, the value of her retained life estate in that half. As to the *inter vivos* trust, the Court of Appeals held (Pet. 100) there was a completed gift when Daniel died and the trust became irrevocable. His community one-half fell into his taxable estate, and the surviving spouse (Marie) made a taxable gift of the other half less her retained life estate in that half.

ARGUMENT

1. The Court of Appeals correctly held that upon Daniel's death there was a completed gift by Marie of half the insurance proceeds, less only the value of her retained life estate in that half. That is so because Daniel, as managing agent of the community, had the right to revoke the trust and to change the beneficiaries of the insurance so that any gift was incomplete until he died. But when he died, the trust became irrevocable and the rights of the beneficiaries became absolute. In such circumstances it has long been settled that for tax purposes the gift became complete, effective and taxable at that time. *Burnet v. Guggenheim*, 288 U.S. 280; *Estate of Sanford v. Commissioner*, 308 U.S. 39. The husband's share (represented by half the proceeds) would be includable in his gross estate for federal estate tax purposes under Section 811(g) of the 1939 Code (*Lang* v.

Commissioner, 304 U.S. 264; *Chase Nat. Bank* v. *United States*, 278 U.S. 327; Treasury Regulations 105, Section 81.27(a),[3] as amended by T.D. 5699, 1949–1 Cum. Bull. 181, 189; Rev. Rul. 48, 1953–1 Cum. Bull. 392); and the remaining half of the proceeds, representing the wife's share, became a gift by the wife for federal gift tax purposes, except as to what she retained.

Thus, the applicable Regulations (Treasury Regulations 108, Section 86.2(a), Appendix, *infra*, pp. 14–15) specifically provide in example 9 that where property held by husband and wife as community property is used to purchase insurance upon the husband's life and a third person is revocably designated as beneficiary and under state law the husband's death is considered to make absolute the transfer by the wife, there is a gift by the wife at the time of such death of half the amount of the proceeds of the insurance. This regulation is reasonable and consistent with the statute (Internal Revenue Code of 1939, Section 1000, Appendix, *infra*, p. 12), which imposes a tax upon the transfer of property by gift whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible. See *Smith* v. *Shaughnessy*,

[3] Section 81.27(a) of Treasury Regulations 105 provides in part as follows:

"For the purposes of this paragraph, where premiums or other consideration are paid with property held as community property by the decedent and his spouse, the decedent shall (in the absence of additional circumstances showing payment indirectly by the decedent) be deemed to have paid only one-half of such premiums or other consideration. * * *"

318 U.S. 176, 180; *Robinette* v. *Helvering*, 318 U.S. 184, 186–187; *Commissioner* v. *Wemyss*, 324 U.S. 303, 306.

The Court of Appeals rightly sustained Section 86.2(a) of Regulations 108 in the instant case (Pet. 87–88), pointing out (Pet. 88–90) that the gift tax is a transfer tax and the proceeds of the insurance are a measure of the value of the property transferred. Similarly, where the wife in a common law state took out insurance on the life of her husband and placed it in a trust for the benefit of their children, reserving the right to revoke during his lifetime, it was held there was a gift measured by the value of the proceeds when he died and the trust became irrevocable. *Goodman* v. *Commissioner*, 4 T.C. 191, affirmed, 156 F. 2d 218 (C.A. 2). And cf. *Goodman* v. *Granger*, 243 F. 2d 264 (C.A. 3), certiorari denied, 355 U.S. 835.

The taxpayer contends (Pet. 5–10) that there is a direct conflict with *United States* v. *Bess*, 357 U.S. 51, but plainly no such conflict exists. And the Court of Appeals correctly so held. (Pet. 90.) The *Bess* case holds that only the cash surrender value of a life insurance policy taken out by the decedent on his own life, and not the proceeds, can be considered as property of the insured for purposes of the federal income tax transferee liability provisions. The taxpayer would extend this to mean that only Marie's half of the cash surrender value of the policies on Daniel's life, and not half the proceeds, can be treated as property of Marie for gift tax purposes. No such extension is warranted. The *Bess* case was not dealing

with gift taxes at all. The gift tax is a transfer tax like the estate tax, and for the purposes of those taxes the proceeds of insurance in a case like the instant one must be treated as the property of the transferor. See *Rowen* v. *Commissioner*, 215 F. 2d 641, 646 (C.A. 2).

The taxpayer says (Pet. 10) that the gift tax transferee statute (Section 1025, Internal Revenue Code, Appendix, *infra*, p. 13) does not explicitly spell out transferee liability for life insurance proceeds as does the estate tax statute (Sections 827 and 900 of the 1939 Code). That is of little significance here. The gift tax statute plainly undertakes to impose liability for the tax on the donee when it is not paid by the donor (Section 1009 of the 1939 Code). As pointed out by the Court of Appeals in the instant case (Pet. 91) the estate and gift tax are in *pari materia* and must be construed together. *Merrill* v. *Fahs*, 324 U.S. 308, 311. It would be strange indeed if Congress intended to collect an estate tax on insurance proceeds from the beneficiary's share but a gift tax on only the cash surrender value of the policy. The entire property (measured in value by the proceeds) passed out of the community when Daniel died, and all of it would naturally be subject to transferee liability in both situations.

We submit that in the circumstances the Treasury correctly formulated the regulation (Treasury Regulations 108, Section 86.2(a) example (9)), alluded to above, to the effect that in a case like the instant one, one-half of the amount of the proceeds of the insurance (less what she retains) constitutes a gift by the

wife. The Court of Appeals made no error in upholding the regulation (R. 87–88) and sustaining the tax (R. 90–91.)

2. From what has been said above in relation to the insurance trust, it follows logically that upon Daniel's death there was a gift by Marie of half the value of the corpus of the *inter vivos* trust less only the value of her retained interest in such half. The Court of Appeals correctly so held. (Pet. 91–100.)

Taxpayer asserts (Pet. 10–15) a direct conflict with *Commissioner* v. *Siegel,* 250 F. 2d 339 (C.A. 9), both as to the insurance trust and the *inter vivos* trust. There is no such conflict. The Court of Appeals in the instant case was well aware of *Siegel* and mentioned it in at least two places in its opinion. (Pet. 52, 99.) In the latter of these the Court of Appeals said:

> We hold that the Moran living trust was not ambulatory; it was a present, valid trust created in 1928. Marie is the income beneficiary under the express terms of that trust and not because she receives the income in exchange for relinquishing her half of the community as part of an assumed election to accept the benefits of the trust. We do not have before us, therefore, the question at issue in *Commissioner* v. *Siegel,* 9 Cir., 1958, 250 F. 2d 339, that is, whether the wife's election to take under the will should be considered as a gift by the wife or a purchase of an annuity supported by consideration.

In other words, the whole doctrine of the *Siegel* case turns on whether there was an election. In that

case the husband undertook to dispose of the entire community property, including both his and his wife's, by his own personal, individual will; and she was expressly put to an election thereunder. She elected to take the provision made for her by Mr. Siegel in his will in lieu of asserting her community property rights and the total value of what she gave up was greater than what she got so she unquestionably had made a gift. The only question was whether in evaluating her gift there should be deducted not only what she retained out of her own property but also what her husband gave to her as consideration for acceding to the terms of the will.* Plainly *Siegel* and the instant case are not in conflict since the very foundation of the issue in *Siegel,* namely an election by the wife, is absent here.

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* It is our view that *Siegel* was incorrectly decided and that what the wife got from her husband came to her as a pure gift and not as a result of a bargaining or sales transaction and, therefore, should not be deducted. In other words, the wife was not the purchaser of a life estate in her husband's property within the meaning of the tax laws, but she was rather a beneficiary of his bounty to the extent of what she got from his share of the community property. Nothing passed from her to her husband or his estate. Cf. *Commissioner* v. *Wemyss*, 324 U.S. 303, 307–308; *Robinette* v. *Helvering*, 318 U.S. 184, 187–188; *Helvering* v. *Butterworth*, 290 U.S. 365, 369–370.

CONCLUSION

The decision of the Court of Appeals is correct. There is no conflict of decisions. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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FEBRUARY 1959.

APPENDIX

Internal Revenue Code of 1939:

SEC. 1000. Imposition of Tax.

(a) For the calendar year 1940 and each calendar year thereafter a tax, computed as provided in section 1001, shall be imposed upon the transfer during such calendar year by any individual, resident or nonresident, of property by gift. Gift taxes for the calendar years 1932–1939, inclusive, shall not be affected by the provisions of this chapter, but shall remain subject to the applicable provisions of the Revenue Act of 1932, except as such provisions are modified by legislation enacted subsequent to the Revenue Act of 1932.

(b) The tax shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible; but, in the case of a nonresident not a citizen of the United States, shall apply to a transfer only if the property is situated within the United States.

(26 U.S.C. 1000.)

SEC. 1002. Transfer for Less Than Adequate and Full Consideration.

Where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall, for the purpose of the tax imposed by this chapter, be deemed a gift, and shall be included in computing the amount of gifts made during the calendar year.

(26 U.S.C. 1002.)

SEC. 1005. Gifts Made in Property.

If the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift.

(26 U.S.C. 1005)

SEC. 1025. Transferred Assets.

(a) *Method of Collection.*—The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, collected, and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in the tax imposed by this chapter (including the provisions in case of delinquency in payment after notice and demand, the provisions authorizing distraint and proceedings in court for collection, and the provisions prohibiting claims and suits for refunds):

(1) *Transferees.*—The liability, at law or in equity, of a transferee of property of a donor, in respect of the tax (including interest, additional amounts, and additions to the tax provided by law) imposed by this chapter.

(2) *Fiduciaries.*—The liability of a fiduciary under section 3467 of the Revised Statutes (U.S.C., Title 31, § 192) in respect of the payment of any such tax from the estate of the donor.

Any such liability may be either as to the amount of tax shown on the return or as to any deficiency in tax.

(b) *Period of Limitation.*—The period of limitation for assessment of any such liability of a transferee or fiduciary shall be as follows:

(1) Within one year after the expiration of the period of limitation for assessment against the donor.

* * * * * * *

(f) *Definition of "Transferee".*—As used in this section the term "transferee" includes donee, heir, legatee, devisee, and distributee.

* * * * * * *

(26 U.S.C. 1025.)

Treasury Regulations 108, promulgated under the Internal Revenue Code of 1939:

SEC. 86.1. *Imposition of Tax.*—The statute imposes no tax upon property, but subjects to tax transfers of property by gift. The statute taxes all such transfers of property * * * to the extent that they exceed the deductions authorized by section 1004. The tax is not limited in its imposition to transfers of property without a valuable consideration, which at common law are treated as gifts, but extends to sales and exchanges for less than an adequate and full consideration in money or money's worth. (See section 86.8.) * * *

* * * * *

SEC. 86.2 [as amended by T.D. 5698, 1949-1 Cum. Bull. 226]. *Transfers Reached.*—(a) *In general.*—The statute imposes a tax whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible. Thus, for example, a taxable transfer may be effected by the declaration of a trust, the forgiving of a debt, the assignment of a judgment, the assignment of the benefits of a contract of insurance, or the transfer of cash, certificates of deposit, or Federal, State, or municipal bonds. * * * Inasmuch as the tax also applies to gifts indirectly made, all transactions whereby property or property rights or interests are gratuitously passed or conferred upon another, regardless of the means or device employed, constitute gifts subject to tax. See, further, section 86.8. * * * In the following examples of transactions resulting in taxable gifts, it will be understood that the transfers were not made for an adequate and full consideration in money or money's worth:

* * * * *

(9) Where property held by a husband and wife as community property is used to purchase insurance upon the husband's life and a third person is revocably designated as beneficiary and under the State law the husband's death is considered to make absolute the transfer by the wife, there is a gift by the wife at the time of such death of one-half the amount of the proceeds of such insurance. (For special provisions with respect to transfers of community property after ~~1942 and on~~ or before April 2, 1948, see subsection (e) of this section.)

SEC. 86.3. *Cessation of Donor's Dominion and Control.*—The tax is not imposed upon the receipt of the property by the donee, nor is it necessarily determined by the measure of enrichment resulting to the donee from the transfer, nor is it conditioned upon ability to identify the donee at the time of the transfer. On the contrary, the tax is a primary and personal liability of the donor, is an excise upon his act of making the transfer, is measured by the value of the property passing from the donor, and attaches regardless of the fact that the identity of the donee may not then be known or ascertainable.

As to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to change the disposition thereof, whether for his own benefit or for the benefit of another, the gift is complete. But if upon a transfer of property (whether in trust or otherwise) the donor reserves any power over the disposition thereof, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case. Accordingly, in every case of a transfer of property subject to a reserved power, the terms of the power must be examined and its scope determined.

A gift is incomplete in every instance where a donor reserves the power to revest the beneficial title to the property in himself. A gift is also incomplete where and to the extent that a reserved power gives the donor the right to name new beneficiaries or to change the interests of the beneficiaries as between themselves.

* * *

* * * * * *

SEC. 86.8. *Transfers for a Consideration in Money or Money's Worth.*—Transfers reached by the statute are not confined to those only which, being without a valuable consideration, accord with the common law concept of gifts, but embrace as well sales, exchanges, and other dispositions of property for a consideration in money or money's worth to the extent that the value of the property transferred by the donor exceeds the value of the consideration given therefor. However, a sale, exchange, or other transfer of property made in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from any donative intent), will be considered as made for an adequate and full consideration in money or money's worth. A consideration not reducible to a money value, as love and affection, promise of marriage, etc., is to be wholly disregarded, and the entire value of the property transferred constitutes the amount of the gift.

SEC. 86.17. *Gifts Made in Property.*—A gift made in property is subject to the tax in the same manner as a gift of cash, and the amount of the gift is the value of the property at the date of the gift.

SEC. 86.58. *Claims in Case of Transferred Assets.*—The amount for which a transferee of the property of a donor is liable, at law or in equity, and the amount of the personal liability of a fiduciary under section 3467 of the Revised Statutes, as amended by section 518 of the Revenue Act of 1934, 31 U.S.C. 192, in respect

of the tax, whether such tax is shown on the return of the donor or determined as a deficiency, shall be assessed against such transferee or such fiduciary, as the case may be, and collected and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in the tax, except as hereinafter provided.

The term "transferee" as used in this section includes among others a donee, heir, legatee, devisee, and distributee.

The period of limitation for assessment of the liability of a transferee or of a fiduciary, is as follows:

(1) Within one year after the expiration of the period of limitation for assessment against the donor.

* * * * * *

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